Supreme Court, U.S.
FILED
SEP - 8 2015
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Nos. 14-840 and 14-841

IN THE

# Supreme Court of the United States

FEDERAL ENERGY REGULATORY COMMISSION,
*Petitioner,*
v.
ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,
*Respondents.*

ENERNOC, INC., *et al.*,
*Petitioners,*
v.
ELECTRIC POWER SUPPLY ASSOCIATION, *et al.*,
*Respondents.*

**On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

## BRIEF OF *AMICUS CURIAE* PUBLIC UTILITY LAW PROJECT OF NEW YORK IN SUPPORT OF RESPONDENTS

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September 8, 2015

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

## QUESTIONS PRESENTED

Question 1: Whether The Federal Energy Regulatory Commission Reasonably Concluded That It Has Authority Under The Federal Power Act, 16 U.S.C. 791a Et Seq., To Regulate The Rules Used By Operators Of Wholesale Electricity Markets To Pay For Reduction In Electricity Consumption And To Recoup Those Payments Through Adjustments To Wholesale Rates.

Question 2: Whether The Court Of Appeals Erred In Holding That The Rule Issued By The Federal Energy Regulatory Commission Is Arbitrary And Capricious.

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## INTEREST OF AMICUS CURIAE [1]

The Public Utility Law Project of New York, Inc. ("Project") is a nonprofit organization formed in 1981 to promote and defend the interests and rights of low and fixed income utility consumers in matters affecting affordability, universal service, and consumer protection. The Project educates the public about rates for utility service, conducts research on the effects of utility regulation, and provides legal representation to enforce the rights of residential utility consumers.

Residents of New York State received electric energy from vertically integrated utilities[2] until the utilities divested most of their power plants and formed new holding companies under encouragement from the New York Public Service Commission in the late 1990's.[3] Fourteen other states and the District of Columbia adopted this restructuring model, which severs the function of electric energy generation from the retail distribution utilities.[4]

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[1] No person other than the named *amicus* or its counsel authored this brief or provided financial support for it. All parties have consented to the filing of *amicus* briefs.

[2] Association Of The Bar of The City of New York, Committee on Energy, *Electric Utility Restructuring in New York: A Status Report*, 53 The Record 347, 353 (May/June 1998).

[3] *Id.* at 3634.

[4] For a map with state-by-state information on electricity restructuring, see *Status of Electricity Restructuring by State, U.S. Energy Info. Admin.* http://www.eia.gov/electricity/policies/restructuring/restructure_elect.html, (last updated Sept. 2010), last visited August 14, 2015. EIA indicates fourteen states and the District of Columbia as restructured, with the remainder of states under traditional state regulated vertically integrated

Due to the restructuring, retail utilities in New York and other retail electric load serving entities now must purchase at wholesale nearly all of the electric energy resold to end-use retail customers. With Federal Energy Regulatory Commission (FERC) approval, in addition to managing the bulk power grid, the New York Independent System Operator (NYISO) began to run "organized markets" to facilitate the interstate sale of energy, capacity, and other services under FERC's jurisdiction. After this restructuring, wholesale rate regulation by FERC became even more important to customers.[5]

New York residential customers already pay some of the nation's highest rates for electricity.[6] High rates presently cause major economic hardship for New York's low-income customers, many of whom, due to indebtedness to utilities, are threatened with shutoffs as a bill collection measure.[7] FERC's "demand

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monopoly providers. Seven states suspended restructuring plans, and no state has restructured since the demise of Enron in 2001.

[5] Wholesale rates allowed by FERC eventually are passed through to retail customers. *Entergy La., Inc. v. La. PSC*, 539 U.S. 39 (2003), *Nantahala Power and Light Co. v Thornburg*, 476 U.S. 953 (1986).

[6] For a chart showing the average price of electricity to consumers listed by State across all sectors, see *Electric Power Monthly, Table 5.6.A. Average Retail Price of Electricity to Ultimate Customers by End-Use Sector*, U.S. Energy Info. Admin., http://www.eia.gov/electricity/monthly/epm_table_grapher.cfm?t=epmt_5_06_a, (June 2015), last visited September 1, 2015. EIA indicates that the residential average price of electricity in New York in June 2015 was 18.81 cents per kilowatt hour.

[7] "As of April 30, 2015, there were 1,037,651 residential customers who were more than 60 days in arrears, carrying nearly $799 million owed to utilities; and 295,797 residential customers statewide had utility service disconnected for

response" program poses a serious risk to vulnerable retail consumers because the proposed rates for electric energy will continue to be higher than many can afford. FERC's failure to correct excessive charges demanded and received by wholesalers of electric energy and FERC's continued reliance upon illusory "market-based" solutions will most likely cause more serious harm to residential customers, particularly those with low incomes already facing hardship, other rate increases, and decreased assistance in the form of low-income rates.[8] The Project submits this brief in support of affirmance of the decision below.

## STATEMENT

FERC is attempting to shed its statutory role as regulator of wholesale rates and charges of interstate electric energy sellers.[9] It seeks to morph from a price

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nonpayment during the preceding 12 months." State of New York Public Service Commission, Staff Report, Case No. 14–M-0565, *Proceeding on Motion of the Commission to Examine Programs to Address Energy Affordability for Low Income Utility Customers*, p.4 (June 1, 2015). This Court has also observed that "the uninterrupted continuity of [electric service] is essential to health and safety." *Memphis Light, Gas & Water Div. v. Craft*, 46 U.S. 1, 18 (1978).

[8] Under a recent recommendation of the New York Public Service Commission Staff to revise low-income rates "more than 85 percent of Con Edison's low income program participants will receive a smaller discount than they currently receive." Consolidated Edison Company of NY, Inc. and Orange and Rockland Utilities, Inc., Comments on the State of New York Public Service Commission Staff Report, Case No. 14–M-0565, *Proceeding on Motion of the Commission to Examine Programs to Address Energy Affordability for Low Income Utility Customers*, p.7 (August 24, 2015).

[9] "[W]ithin electricity law, demand response programs are merely the latest example of FERC's self-help approach to

regulator into a market overseer, prescribing rules of private "organized markets" in which energy is sold at unregulated "market-based-rates", indifferent to actual prices set in the market if the market is deemed to be sufficiently competitive. To accomplish this transformation of the regulatory paradigm, FERC grants public utility sellers the "privilege" to charge unfiled "market-based-rates" if they pass a market power screen, a measure of whether the seller single-handedly could move prices significantly.[10] The assumption is that the sellers who pass FERC's market power test will satisfy the statutory standard that all their rates and charges demanded and received must be "just and reasonable."[11]

FERC does not enforce the statutory advance public filing requirement for of all changes in rates and

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jurisdictional boundaries. Sharon B. Jacobs, *Bypassing Federalism and the Administrative Law of Negawatts*, 100 Ia. L. Rev. 885 (2015).

[10] "The authorization to sell power at market-based rates . . . – as opposed to traditional, cost-based rates – is a privilege...." Order Denying Rehearing, *Enron Power Mktg., Inc.*, et al., 106 FERC P 61,024, P 13 (2004). "The Commission grants market-based rate authorization for wholesale sales of electric energy, capacity and ancillary services by sellers that can demonstrate that they and their affiliates lack or have adequately mitigated horizontal and vertical market power." FERC website, *Electric Market-Based Rates* homepage, http://www.ferc.gov/industries/electric/gen-info/mbr.asp, last visited July 29, 2015.

[11] The Court termed this assumption "metaphysical" in *Morgan Stanley Capital Grp., Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527 (2008). In *MCI Telecomms. Corp. v. AT&T Co.*, 512 US 218 (1994), where the FCC attempted to institute a detariffing policy for nondominant carriers under its modification authority within 47 USCS § 203, this Court also expressed skepticism as to the efficacy of regulating only those with dominant market power.

charges for sellers with the market rate "privilege."[12] The "organized market" operators receive secret rate demands or "bids" from sellers in auctions for each day and hour, and pay the same spot market clearing price to all sellers whose rate demands are at or less than the price of the market clearing bid, or "locational marginal price" ("LMP"). This price is paid to all sellers whose output is dispatched to satisfy predicted demand, regardless of the individual sellers' costs or profits.[13]

FERC recognized in a rulemaking proceeding that the unfiled charges demanded and rate changes allowed by the "organized markets" may be excessive and vulnerable to the exercise of market power by market participants,[14] particularly at times of the day when peaker plants (or possibly other sellers demanding much higher prices for a segment of their baseload plant output)[15] are dispatched to meet rising

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[12] Federal Power Act, 16 U.S.C. § 824d(d).

[13] "[I]n the absence of market power concerns in the current competitive wholesale energy market, FERC does not "inquire into the costs or benefits of production for the individual resources participating as supply resources," and it pay[s] LMP to generators without regard to their individual costs or benefits. FERC Merits Brief at 18 – 19.

[14] NPRM Establishing Order 745 at 13, Jt. Appellant's brief at 35.

[15] "[A] bid is not merely a function of variable costs." Re NYISO, FERC Dkt. No. EL03-26-004, *Order Modifying and Accepting Compliance Filing* (March 4, 2005). FERC allows sellers of output from baseload plants to segment their bids at escalating prices. The cumulative effect of strategic bidding of a segment of output by multiple baseload suppliers, not based on operating costs, but based on an estimate of the clearing prices attainable in the next day's real time market, may be to

demand. Apparently recognizing that its "market-based rates" regime does not yield just and reasonable rates, FERC put forward a market-based remedy: "demand response" payments to certain retail customers for not using electricity, in the hope that the demand reduction would lower market prices. In the decisions now on review,[16] FERC determined that unless "demand response" programs in "organized wholesale markets" it has fostered pay participating retail customers for not using electricity at the same market-based rate as is set for the sale of electric energy, the "organized market" rates and charges for electric energy are unreasonable.[17]

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economically withhold a portion of output until higher prices are reached.

[16] *Demand Response Compensation in Organized Wholesale Energy Markets*, 134 FERC ¶ 61,187, 2011 WL 890975, at *30 (Mar. 15, 2011) [hereinafter Order 745].

[17] FERC stated in Order 745:

> "We find, based on the record here that, when a demand response resource has the capability to balance supply and demand as an alternative to a generation resource, and when . paying LMP to that demand response resource is shown to be cost-effective as determined by the net benefits test described herein, payment by an RTO or ISO of compensation other than the LMP is unjust and unreasonable. *When these conditions are met, we find that payment of LMP to these resources will result in just and reasonable rates for ratepayers.*

Order 745, 134 FERC ¶ 61,187, 2011 WL 890975, at 13 (emphasis added), *Elec. Power Supply Ass'n v FERC*, 753 F.3d 216, 231 [D.C. Cir. 2014]. Implicit in FERC's conclusion is a finding that without "demand response," rates for ratepayers are not "just and reasonable."

FERC's solution was not to fix any unjust or unreasonable -- and hence illegal[18] -- rates, charges or practices of sellers. Rather, FERC created the market remedy of "demand response" payments to certain participating retail customers not to use electricity, in the hope that a decline in their demand would avert price spikes, making spot market clearing prices lower than they otherwise would be. Although "demand response" rewards certain customers generously not to use electricity, it is questionable whether the added payments will work to reduce charges paid over time by ordinary consumers or remedy or prevent unjust and unreasonable rates.

The court below held that FERC's final rule Order 745 is an invalid encroachment on the states' exclusive jurisdiction to regulate the retail market.[19] This Court's affirmance of the D.C. Circuit Court of Appeals decision will redirect FERC to adopt other means to correct or prevent excessive charges in "organized market" rates, in accordance with its statutory mandate to provide consumers a complete bond of protection against unreasonable rates and charges, and in a manner that does not impermissibly overreach the agency power vested in it by Congress.

Implicit in FERC's decisions and the decision of the lower court is an assumption that FERC's "market-based rates" regimen, which allows the unregulated private setting of unfiled rates in private "organized markets", is lawful. This Court, however, has not yet addressed the legality of FERC's market-based rates system:

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[18] "[A]ny such rate or charge that is not just and reasonable is hereby declared to be unlawful." 16 U.S.C. 824d(a).

[19] *Elec. Power Supply Ass'n v FERC*, 753 F3d 216, 218 (2014).

> We have not hitherto approved, and express no opinion today, on the lawfulness of the market-based-tariff system, which is not one of the issues before us. * * * * We reiterate that we do not address the lawfulness of FERC's market-based-rates scheme, which assuredly has its critics.[20]

Similarly, in deciding this case, the Court should take care not to predetermine or implicitly validate FERC's "market-based rate" system.

## ARGUMENT

### I. FERC Lacks Statutory Authority to Set Rates for "Demand Response" Payments to Retail Customers for Not Using Electricity.

Putting aside FERC's new focus on market structure rather than the rates and charges of individual sellers,[21] the issue presented here is whether FERC can lawfully set market rates for "demand response" payments to retail customers and add the costs of those payments to the charges paid by wholesale buyers of electric energy in the "organized markets".[22] The Court below held that FERC lacks jurisdiction to

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[20] *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 548 (2008).

[21] See *MCI Telecomms. Corp. v. AT&T Co.*, 512 US 218 (1994), where the Court noted potential flaws in the FCC's rationale for only regulating rates of dominant carriers with market power, and not requiring others to file their rates.

[22] "As a federal agency, FERC is a "creature of statute," having "no constitutional or common law existence or authority, but only those authorities conferred upon it by Congress. * * * * Thus, if there is no statute conferring authority, FERC has none. * * * * In the absence of statutory authorization for its act, an agency's "action is plainly contrary to law and cannot stand." *Atl. City Elec. Co. v. FERC*, 353 U.S. App. D.C. 1, 295 F.3d 1, 8 (2002).

implement the "demand response" program, agreeing with Respondents that it transgresses "the states' exclusive jurisdiction to regulate the retail market." *EPSA v. FERC*, 753 F.3d 216, 218 (D.C. Cir 2014).

Respondents in their brief persuasively demonstrate that "FERC's effort to regulate 'demand response' is an effort to regulate retail sales, countermand state decisions concerning retail rates, and manipulate retail demand." *Respondents' Brief, 16.* The Project agrees with Respondents' arguments, and emphasizes the following additional points.

FERC's assertion of jurisdiction to pay retail customers for not using electricity is recent,[23] and substantive provisions of the Federal Power Act do not support it. Section 205 of the Federal Power Act

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[23] "A recent study by the Government Accountability Office (GAO 2004) concluded that a majority of the actions to address demand response involve retail markets and thus come under the jurisdiction of the states, based on provisions of the Federal Power Act. In EPACT, Congress did not require the states to do demand response but instead required them to consider and investigate demand response and time-based metering based on changes to the Public Utility Regulatory Policies Act of 1978. Congress also authorized DOE and FERC to encourage demand response through information and education on benefits, barriers, and technologies as well as technical assistance. *Absent additional legislative changes from Congress, actions of Federal [regulatory] agencies that affect demand response are limited to wholesale markets.*" U.S. Department of Energy, *Benefits of Demand Response in Electricity Markets and Recommendations for Achieving Them:* A report to the United States Congress Pursuant to Section 1252 of the Energy Policy Act of 2005, Page 52, fn. 58 (Feb. 2006). (*Emphasis added*).

regulates rates and charges of public utility *sellers* of electric energy.[24] For example:

- *Sellers* of electric energy for resale in interstate commerce, not buyers, are regulated as "public utilities" by the Act. 16 U.S.C. § 821(e) (*emphasis added*).
- Only "public utility" *sellers* are required to publicly file their rates, charges, and contracts, 16 U.S.C. § 824d(c) and file any changes to them for review 60 days in advance. 16 U.S.C. § 824d(d) (*emphasis added*). Under FERC's regime, rates demanded by sellers for electric energy and rates for "demand response", which are pegged to energy prices set in the "organized markets," are not filed.[25]
- Only "public utility" *sellers* can have their rates suspended and rate increases made subject to

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[24] "Just and reasonable rates. All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." 16 U.S.C. § 824d(a).

[25] "[T]he 'filed rate doctrine' forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority. * * * * The filed rate doctrine has its origins in this Court's cases interpreting the Interstate Commerce Act, * * * * and has been extended across the spectrum of regulated utilities. The considerations underlying the doctrine are preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant. * * * *" *Ark. La. Gas, Co. v. Hall*, 453 U.S. 571, 577 - 578 (1981).

> refund while no provision is made for retroactively collecting undercharges. 16 U.S.C. § 824d(e) (*emphasis added*).

The Federal Power Act was intended to provide consumers with a "complete, permanent and effective bond of protection against excessive rates.[26] FERC's recent innovations, however, risk exposure of customers to excessive "market-based rates" with no remedy. As discussed below, "demand response" is not likely to cure "organized market" dysfunction; indeed, it most likely will increase retail bills and worsen matters for consumers.

Demand response providers – retail customers who accept payments from the "organized market" entities for not using electricity – are neither public utilities nor do they sell electric energy for resale. Thus, FERC's establishment of rates paid to them for not using electricity is not a public utility's sale of electric energy within FERC's purview.[27] FERC argues that the demand response payments are charges made "in connection with the transmission or sale of electric energy subject to the jurisdiction of the

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[26] *Atl. REF. Co. v. PSC of N.Y.*, 360 U.S. 378, 388 (1959).

[27] FERC has recognized this, stating that:

> "[W]here an entity is only engaged in the provision of demand response services, and makes no sales of electric energy for resale, that entity would not own or operate facilities that are subject to the Commission's jurisdiction and would not be a public utility that is required to have a rate on file with the Commission." *EnergyConnect, Inc., Order Conditionally Granting Market-Based Rate Authorization and Proving Guidance*, 130 FERC ¶ 61,031, 30 (2010).

Commission...." 16 U.S.C. 824(a).[28] However, the primary sale of electric energy in the "organized market" auctions is by public utilities that produce or market electric energy. Payments to retail customers for not using electricity, made by the "organized market" operator, are not "in connection with" any particular jurisdictional sale of electric energy by any particular public utility.[29] By requiring "organized market" operators to pay retail customers at rates pegged to unfiled "market-based rates," charged by sellers, and by adding the costs to charges paid by buyers of electric energy, FERC has gone far astray from the statutory focus of the Federal Power Act, which is to review rates and charges filed by public utility sellers of electric energy.[30]

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[28] FERC Br. 32-34; *see also* Order 745, 134 FERC P 61,187, 2011 WL 890975, at *30; *see also Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 231 (2014).

[29] The NYISO takes "flash title" to energy sold as a counterparty between the seller and the buyer in a wash transaction. The NYISO 2014 Annual Financial Report is available at http://www.nyiso.com/public/about_nyiso/nyisoata glance/annual/index.jsp, last visited September 1, 2015. The rate it charges the buyer is the same rate paid to the seller, and the expense of the purchase and revenue from the buyer is not recognized. Thus, the "demand response" payments made to retail customers are also not in connection with the "organized market's" wash sales to the buyers. Instead, the demand response charges paid to retail customers are added to costs of the "organized market's" operations, and separately assessed to buyers.

[30] *See Cal. Indep. Sys. Operator Corp. v. FERC*, 362 U.S. App. D.C. 28, 372 F.3d 395, 398 (2004) (jurisdiction over "practices" of a utility relating to its unreasonable rates did not confer upon FERC general power to revise governance of the CAISO market operator).

FERC also argues that the demand response provisions are "rules and regulations affecting or pertaining to such rates or charges," 16 U.S.C. 824(a).[31] In a tautological sense, of course, any rule adding to the rates and charges of sellers which are then assigned by the market operator to be paid by buyers of electric energy is one "affecting or pertaining to such rates or charges." But as the Court of Appeals noted, under this rationale there is no limiting principle to adding more rules requiring more new charges to be added to sellers' rates. Another example of the potential overreach of FERC's argument – it is possible that a market operator might pay large retail commercial and industrial customers to install energy efficient lighting and motors, to reduce their demand generally as well as at peak times, in the name of reducing demand; reducing rates; reducing the need for peaker plants to run; and improving energy and capacity markets. While not "bid" in the day ahead energy spot market like "demand response" in this case, an energy efficiency/demand reduction scheme might be bid in the forward capacity spot market auctions, tantamount to a long term contract for demand response "negawatts" with the same putative benefits as the energy spot market demand response.[32] One may refute these potential consequences by asserting that the energy efficiency payments and programs would

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[31] FERC Br. 32-34; *see also* Order 745, 134 FERC P 61,187, 2011 WL 890975, at *30; *see also Elec. Power Supply Ass'n v. FERC*, 753 F.3d 216, 221 (2014).

[32] The PJM Regional Transmission Organization already has a program that does this, i.e., pay retail customers in the capacity market to reduce their demand with energy efficiency proposals. *RPM Energy Efficiency (EE) FAQs*, http://www.pjm.com/-/media/markets-ops/rpm/rpm-auction-info/rpm-energy-efficiency-faqs.ashx, visited September 1, 2015.

reduce demand, reduce the hours when peaker prices are paid, and so forth. But even then, that type of action where FERC is allowing the market operator to act with broad license to pay retail electric customers to reduce their usage would also not be within the scope of FERC's existing powers under the Federal Power Act.

Underemphasized by FERC and its *amicii* supporters is the plain wording and meaning of the Federal Powers Act, which limits jurisdiction to practices affecting "such rates or charges." These are the rates or charges of jurisdictional public utility producers and sellers of electric energy. Energy Law Scholars in their *amicus* brief overlook this required nexus to the practices and rules of *sellers*, and stretch it to encompass a relationship to the general concept of the "market", stating, for example, "[i]n short, "practices affecting" jurisdiction attaches for practices that are directly related or integral to *the proper functioning of the wholesale markets*."[33] Plainly, that is not what the statute says – it does not grant FERC plenary power to supervise "the proper functioning of the wholesale markets" by putting its thumb on the scale to reduce demand. Rather, the Federal Power Act allows utility sellers to set and change their rates freely, subject to the statutory rate filing duty, the 60 day advance filing process for rate changes, and potential FERC review and modification if the sellers' rates and charges are not just and reasonable. "To regulate a practice affecting rates pursuant to Section 206, the Commission must find that the existing practice is "unjust, unreasonable, unduly discriminatory or preferential," and that the remedial practice it

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[33] Brief Amicus Curiae of Energy Law Scholars in support of the Petitioners, Section I (C), (filed July 16, 2015).

imposes is "just and reasonable." 16 U.S.C. § 824e(a)." *S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41 (2014) *rehearing, en banc, denied by* 2014 U.S. App. LEXIS 19968 (2014). FERC has not done that here. In sum, the Federal Power Act does not confer upon FERC or the ISO and RTO utilities the power to add or subtract supply and demand in the "market" at buyers' expense in order to attain some vague notion of the proper market equilibrium that indirectly will yield "just and reasonable" rates and charges.

The statute does not permit FERC to delegate to or depend upon the willingness of third parties retail customers and the private market operators – to offer and buy the right amount of usage reductions sufficient to cure unjust and unreasonable spot market rates. Despite paying full LMP to participants in New York's retail "demand response" programs, the New York Public Service Commission stated in the proceedings below that "we have seen little interest from market participants under the New York ISO's LMP-based payment approach."[34] It is a responsibility of the sellers to file reasonable rates and charges in the first instance, not for others to shrink demand in an effort to deter price gouging or strategic bidding. It is the statutory responsibility of FERC to fix sellers' rates when they are not just and reasonable, not to tinker with supply and demand in the wholesale markets. Accordingly, the demand response requirement is not a rule "affecting or pertaining to" the rates demanded or charged by sellers whose rates and charges are the jurisdictional focus of the Federal Power Act.

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[34] Notice of Intervention and Comments of the New York Public Service Commission, May 13, 2010, FERC Docket No. RM10-17-000, at 6.

## II. There is No Need to Address Question 2 if FERC Lacks Power to Prescribe "Demand Response" Rates Paid to Retail Customers

Question 2 concerns controversies over the rate to be paid retail customers for not using electric energy. If the Court in consideration of Question 1 finds that FERC lacks any jurisdiction to establish demand response programs, then Question 2 becomes moot.

## III. If Question 2 is Reached, the Court Should Not Approve a "Market-Based Rate" for Demand Response Payments to Retail Customers

The Question 2 issues pose a choice among variants of "market-based rates" to be paid to certain retail customers for not using electric energy. If the Court does reach the issues incorporated in Question 2, the Court should rule on or remand the matter without approving or implicitly ratifying FERC's "market-based rate" regime for the sale of electric energy.

The Court of Appeals for the District of Columbia has allowed "market-based rates" for electricity,[35] and

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[35] *Dicta* regarding negotiated rates in *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993) is often cited as authority for the "market-based rates" regime, but the issue whether they are consistent with statutory filing requirements was not timely raised in that case and was never considered. The same *dicta* was relied upon in support of unfiled market rates for electricity in *La. Energy & Power Auth. v. FERC*, 141 F.3d 364 (D.C. Cir. 1998). The D.C. Circuit side-stepped the question whether "market-based rates" are consistent with the Federal Power Act in *Colo. Office of Consumer Counsel v. FERC*, 490 F.3d 954 (D.C. Cir. 2007), *cert. denied* 128 S.Ct. 1872 (2008). The Ninth Circuit, in *California ex rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), *cert. denied, Coral Power, L.L.C. v. Cal. ex rel. Brown, 551 U.S. 1140* (2007), relied on the D.C. Circuit's *Elizabethtown Gas*

so did not question the fundamental premise whether any "market-based rate" is permissible, either for electric energy or for demand response payments.[36] The Court has not addressed the legality of FERC's market rate regime for wholesale electric energy, *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 538 (2008), and it is not an issue presented by the parties to this case. If the Court finds that FERC does have jurisdiction to establish rates for demand response, the Court should affirm the decision of the court below on an alternate legal ground, or remand the matter for further proceedings without approving any "market-based rate" either for energy or for "demand response" payments.

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and *LEPA* decisions in holding the "market-based rates" were not unlawful "per se," but held that the regime could only be squared with the FPA if FERC monitored reasonableness of unfiled charges after they were made. The Ninth Circuit adhered to its *Lockyer* precedent when "market-based rates" were challenged in *Mont. Consumer Counsel v. FERC*, 659 F.3d 910 (9th Cir. 2011), *cert. denied sub nom.* 133 S. Ct. 26 (2012). Recently, the Ninth Circuit again required FERC to conduct its post hoc review of spot market charges on another remand. *Cal. Ex rel. Harris v. FERC*, 784 F.3d 1267, 1270 (9th Cir. 2015) ("FERC abdicated its discretion by structuring the remand proceedings in a manner that prevented any meaningful review of sellers' failure to file transaction reports during the crisis").

[36] In *Fed. Power Comm'n v. Texaco, Inc.*, 417 U.S. 380, 399 (1974), the Court stated that "Congress could not have assumed that 'just and reasonable' rates could conclusively be determined by reference to market price)"; *accord*, *Regular Common Carrier Conference v. United States*, 793 F.2d 376, 379 (1986) (Without [a rate contained in a tariff], for example, it would be monumentally difficult to enforce the requirement that rates be reasonable and nondiscriminatory..., and virtually impossible for the public to assert its right to challenge the lawfulness of existing or proposed rates").

## IV. Consequences of Affirmance are Not Dire.

Affirming the decision below will not inexorably lead to the harms postulated by FERC and other supporters of the market-based demand response scheme for addressing deficiencies of the "organized markets." FERC has other means, consistent with statute, to assure that rates for wholesale electric energy are just and reasonable, that they are not excessive, and are not inflated by the exercise of sellers' market power. Moreover, states are free to establish their own retail demand response programs, as New York has done, with their own compensation measures and incentives.[37]

### A. FERC Has The Authority To Require Sellers to Demand and Charge Just and Reasonable Rates and To Revise Unreasonable Rates and Charges.

If the Court determines that FERC lacks power to implement demand response due to its lack of jurisdiction, it is not without power to fix the identified possibility that sellers with market power may be receiving excessive rates in the hourly spot markets where electric energy is sold. In its summary of what it characterizes as the "central" requirements of the Federal Power Act (FPA) FERC completely omits any

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[37] Subject to state statutory authorization, state regulators are free to establish "demand response" programs that require retail utilities to pay LMP, more than LMP, or less than LMP to retail customers who forego the consumption of electric energy. The New York Public Service Commission approved retail utility tariffs that compensate demand response participants at the full LMP price, which the agency agrees is double compensation, but nonetheless asserts is desirable. See New York Public Service Commission Comments, (May 13, 2010), Jt. Appendix 220, at 227.

mention of the obligation of interstate public utility wholesale sellers to file all rates and contracts publicly, pursuant to 16 U.S.C. § 824d(c), and to file all changes in rates 60 days in advance, to permit public and agency review before they take effect. 16 U.S.C. § 824d(d). FERC's truncated summary of "core" features of the statute omits any mention of its powers and duties to fix any rates and charges and contracts that are unjust and unreasonable by revising them, and requiring refunds for the benefit of consumers when appropriate. 16 U.S.C. § 824(e). In stark juxtaposition to FERC's view of the "core" features of its enabling statute, this Court has identified statutory requirements for advance public filing of all rates, charges, and contracts — and changes to them - as being the "core" and "heart" of statutory rate regulation statutes. *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1, 554 U.S. 527 (2008). Accord, MCI Telecomms. Corp. v. AT&T Co.*, 512 U.S. 218 (1994); *Maislin Industries U.S., Inc. v. Primary Steel*, 497 U.S. 116, 132 (1990), (superseded by statute as stated in *Jones Truck Lines v. Scott Fetzer Co.*, 860 F. Supp. 1370 (E.D. Ark. 1994)).

As previously discussed, FERC is attempting to jettison filed rate regulation of wholesale electricity sellers under its jurisdiction, many of whom it now allows to sell unfiled "market-based rates" in the private "organized markets" with daily and hourly auctions run by managers of the bulk power grids. FERC allows these sellers to demand and set rates with no prior public filing, no opportunity for review, and no potential for a consumer remedy when markets that are flawed, gamed, or manipulated impose unreasonable rates and charges that must be paid by ordinary consumers. See Paul B. Mohler, *Has The "Complete And Permanent Bond Of Protection"*

*Provided By FERC Refunds Eroded In The Transition To Market-Based Rates?* Energy Bar Association, 33 Energy Law Journal 41, 74 (2012).

Although recognizing that the market-based system is flawed and the privately set rates in the spot markets may be affected by the exercise of market power and not reasonable, FERC did not follow the process of the Federal Power Act to remedy unjust and unreasonable rates. The Act commands that all wholesale rates demanded, charged and received for electric energy be "just and reasonable" and forbids any "discriminatory or preferential" rates. 16 U.S.C. §§ 824d(a), 824e(a). To enforce these commands, the Federal Power Act requires that any changes in rates or charges be filed with FERC *before* they go into effect, *id.* § 824d(d) — a provision this Court aptly termed the "file-all-new-rates requirement." *NRG Power Mktg., LLC v. Me. PUC*, 558 U.S. 165, 172 (2010); *accord, Morgan Stanley, supra,* 554 U.S. at 531-32, summarizing the statutory scheme. FERC's "market-based rate" system turns these requirements upside down by (1) permitting wholesale sellers to change, demand and receive new rates and charges without publicly filing the changes in advance, (2) abandoning any effective effort to review actual rates and charges demanded and received by sellers to determine whether they are in fact just, reasonable, non-preferential and nondiscriminatory,[38] and (3) discouraging long term filed contracts for cost-based sales of electric energy, resulting in large volumes of energy, the need for much of which can be anticipated months or years in advance, being sold at (or indexed

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[38] *Cal. ex rel. Harris v. FERC*, 784 F.3d 1267, 1273 (9th Cir. 2015).

to) the clearing prices set in flawed day-ahead spot markets.[39]

Affirmance of the decision below would not interfere with FERC's ability to correct unreasonable rates and charges demanded and received by public utility sellers using the panoply of existing lawful remedies, through the rate filing, review and refund processes of Sections 205 and 206 of the Federal Power Act.

### B. FERC's Market Based Solution to Avert Unreasonable Spot Market Prices by Relying Upon Retail Customers to Reduce their Demand May Fail.

Superficially, "demand response" payments reduce clearing prices, by preventing or delaying the dispatch of higher priced generation.[40] But it is questionable whether "demand response" payments will ultimately result in meaningful overall price reductions. Underlying the assumption that market clearing prices will be lowered are dubious implicit premises: the proponents assume that in the face of lower customer demand, future supply and ordinary demand would remain constant and sellers in the "organized markets" would bid their rate demands in exactly the

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[39] Reminiscent of the FCC forbidding the filing of tariffs by non dominant carriers like MCI, see *MCI Telecomms. Corp. v. AT&T Co.*, 512 US 218 (1994). FERC forbade the filing of contracts by sellers to whom it has granted the "privilege" of selling at "market-based rates", see 18 CFR 35.1(g) (2006) ("'[A]ny market-based rate agreement pursuant to a tariff shall not be filed with the Commission'").

[40] See, *e.g.*, FERC Order 719-A, *Wholesale Competition in Regions with Organized Electric Markets*, 128 FERC ¶ 61,059, p. 47, 2009 WL 2115220 at *12, where FERC states "[L]ower demand means a lower wholesale price."

same way as before the "demand response" program. The same assumption underlies the "what if" back cast analyses touted in support of "demand response," which estimate large amounts of savings if only a few hours of peaker type prices had been avoided with "demand response" in the past.[41] Faith in the "demand response" market solution assumes that demand growth due to economic expansion will not outstrip the amount of demand that can be reduced with "demand response"; that sellers will not - in reaction to the "demand response" alter their bidding strategies so as to maintain peak period pricing;[42] or that sellers will not eventually react to the demand reduction with a "supply response" of their own, to shrink supply by shutting down power plants[43] and restoring the need

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[41] See, e.g., Grid Engineers and Experts *amicus* brief at 26, citing a study claiming if there had been a three percent demand reduction in 100 hours when peak prices were paid it could have saved $138 – $281 million.

[42] See Richard Rosen, Max Duckworth, Aleksandr Rudkevich, *Modeling Electricity Pricing in a Deregulated Generation Industry: The Potential for Oligopoly Pricing in a Poolco (Tellus 1998)*. Regarding economic withholding by a power generator after new electric capacity entered the New York City market, see *United States v Morgan Stanley*, 881 F.Supp.2d 563, 568 (S.D.N.Y. 2012) ("Given the Government's stark allegations of manipulative conduct against Morgan Stanley, disgorgement of $4.8 million is a relatively mild sanction. There is a risk that a large financial services firm like Morgan Stanley could view such a modest penalty as merely a cost of doing business. But despite this Court's misgivings, the Government's decision to settle for less than full damages is entitled to judicial deference....").

[43] During the "polar vortex" price spikes, "PJM saw as much as 22% of its generation out of service in early January, three times the normal winter outage rate." RTO Market Insider, *Monitor Suggests Price Gouging by Generators*, May 20, 2014,

for more hours of peaker plant operation, or more accepted bids of baseload plants demanding higher prices.

But sellers may take their own "supply response," through mothballing of plants or more subtle extended outages[44] or by economic withholding, bidding a portion of their output high to effectively subtract supply from the market. This, or simple growth in demand for other reasons, could exhaust the amount of "demand response" resources offered by retail customers, and maintain or even increase the need for more peaker services at possibly even higher prices when a new price equilibrium level based on supply reduction is achieved. For example, if 200 megawatt hours of electric energy can be reduced through buyers' "demand response" the impact of that could be more than negated by closure of a 300 megawatt power plant, with the possible result that even after applying the demand response resources, high peaker type

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http://www.rtoinsider.com/mm-q1-generators-pricing/, visited August 17, 2015.

[44] Regarding plant closings that reduce supply and drive up spot market auction prices, see Platts, *NRG to close 380-MW Huntley coal-fired plant, puts Dunkirk conversions on hold*, August 15, 2015 ("capacity and other energy prices have made the plant uneconomic to run"), http://www.platts.com/latest-news/coal/birmingham-alabama/nrg-to-close-380-mw-huntley-coal-fired-plant-21022444, last visited August 28, 2015; RTO Insider, *FERC Commissioners at Odds over ISO-NE Capacity Auction*, September 17, 2014, http://www. rtoinsider.com/ferc-at-odds-iso-ne-capacity/, visited August 17, 2015. ("The [NE ISO's] eighth Forward Capacity Auction (FCA) resulted in a sharp price increase after nearly 3,000 MW of capacity submitted retirement requests.... The ISO said total capacity costs for 2017/18 would be $3.05 billion, almost double the previous high ($1.77 billion in 2009").

prices might need to be paid in even more hours than before.

The possibility of supply reductions through physical shutdown or economic withholding in the "organized market" auctions is not remote. Contrary to textbook portrayals of the spot auction markets,[45] bidders are allowed to segment bids and bid a portion of baseload output at prices far higher than their actual running costs of fuel and operating expenses, contrary to what the textbook theory predicts.[46] The cumulative effect of this by multiple sellers is economic withholding of lower cost output, so that high prices will be attained sooner and in more hours. The real effect of FERC's "demand response" program may only be to give a share of the sellers' rents from the dysfunctional "organized markets" to retail "demand response" participants, without lowering ultimate wholesale prices passed through to ordinary consumers, and possibly raising them. Under FERC's

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[45] Grid managers and experts at page 25 of their *amicii* brief foster the notion that generation is called to run by grid operators based on *costs*, citing Joskow, 26 J. Econ. Perspectives at 33 ("As demand increases, 'dispatchable' generating capacity—first 'base load,' then 'intermediate,' then 'peaking' capacity—with higher and higher marginal operating costs, is called to balance supply and demand"). Actually, strategic bidding enables sellers with baseload plants to charge high prices for segments of their output unrelated to their running costs. See Richard Rosen, Max Duckworth, Aleksandr Rudkevich, *Modeling Electricity Pricing in a Deregulated Generation Industry: The Potential for Oligopoly Pricing in a Poolco*, Energy Journal, Vol. 19, No. 3, 1998, pp 19-48; IAEE.

[46] Emmanuel Dechenaux and Dan Kovenock, *Tacit Collusion and Capacity Withholding in Repeated Uniform Price Auctions*, RAND Journal of Economics Vol. 38, No. 4, Winter 2007 pp. 1044–1069

current "market-based rate" regime, there is no adequate consumer remedy when rates are excessive.[47]

There are other problems with "demand response" which detract from its claimed value. For example, self-generation by "demand response" participants may reduce or negate the putative environmental benefit of FERC's program.[48] New reliability complications are introduced because "demand response" payees may not reduce their usage as much or as soon as requested. Also, reduced deliveries through the grid to the large customers who participate in "demand response" and substitute their own self-generation could also reduce their contribution to meeting fixed distribution utility costs, shifting more

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[47] "[I]t is unlikely, even where a market rate is found to be unjust or not in conformance with the filed rate, that consumers will receive timely refunds for amounts paid in excess of the rate later determined to be just and reasonable." Paul B. Mohler, *Has The "Complete And Permanent Bond Of Protection" Provided By FERC Refunds Eroded In The Transition To Market-Based Rates?* 33 Energy Law Journal 41, 74 (2012).

[48] "Another environmental consequence of demand response programs is related to the fact that a substantial percentage of customers participate not by reducing their energy consumption but by switching to on-site back-up generation.**** Diesel generators account for much of this back-up generation... They are also one of the dirtier sources of electricity." Sharon B. Jacobs, *Bypassing Federalism and the Administrative Law of Negawatts*, 100 Ia. L. Rev. 885 (2015).

of those to ordinary nonparticipating residential retail customers.

### C. Affirmance Will Encourage Appropriate Recourse to Congress for Statutory Changes Authorizing "Demand Response" Programs

Reversal of the decision below would encourage FERC in its abandonment of procedures created by Congress for assuring reasonableness of wholesale electric rates. It would tend to reward an agency for overthrowing its statutory role as regulator of all jurisdictional rates to assure they are "just and reasonable."[49] In contrast, affirmance will encourage FERC and other advocates of "demand response" payments to retail customers in "organized markets," to seek enabling legislative authority for "market-based rates" and market-based compensation to participating retail customers for demand reductions at the behest of utilities operating "organized markets."

In the legislative process, the competing policy and stakeholder interests are better balanced, and may be coupled with statutory measures more protective of consumers because of the broader policy concerns and powers of Congress. Indeed, in the aftermath of this Court's decision in *MCI Telecomms. Corp. v. AT&T*

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[49] "[B]y making the existing jurisdictional framework appear more workable, bypassing can mask the existence of disconnects between statutory jurisdictional allocations and modern exigencies. ... [B]ecause FERC's strategy allows it to report progress on demand-side management generally, the approach may be muting signals to Congress that legislative intervention is needed." Sharon B. Jacobs, *Bypassing Federalism and the Administrative Law of Negawatts*, 100 Ia. L. Rev. 885 (2015).

*Co.*, 512 U.S. 218 (1994), which struck down the FCC's effort to detariff rates of non dominant carriers without statutory authorization, Congress enacted the Telecommunications Act of 1996, which established a new regulatory paradigm for competitive services. The 1996 Act included measures protective of affordable universal service and supportive of rural and low income customer access to both telephone and advanced communications services -- matters that the FCC did not or could not address absent the statutory change.

Similarly, affirmance would motivate industry proponents of electricity deregulation and well-intentioned regulators and other supporters of "demand response" to seek necessary legislative authority which, if granted, may be coupled with measures more protective of consumers than FERC can or will provide, because of the broader policy concerns and powers of Congress.

## CONCLUSION

FERC's "demand response" program poses serious risks to vulnerable retail consumers that rates for electric energy will be higher than they can afford. In deciding Question 1, the Court should affirm the District of Columbia Circuit decision insofar as it holds that FERC lacks any statutory authority to add the cost of "demand response" payments made to retail customers for not using electricity to charges paid by wholesale buyers of electric energy, which are eventually passed through to retail customers.

If the Court affirms on the ground that FERC's demand response program impermissibly intrudes upon state ratemaking prerogatives, it need not reach or decide Question 2. Alternatively, if the Court finds

that FERC has power to implement "demand response" programs, in deciding Question 2 the Court should refrain from ruling on validity of "market-based rate" options for demand response payments. The Court is urged not to endorse or lend any implicit support to FERC's "market-based rates" regime, legality of which is an open and as yet undecided issue.

Respectfully submitted,

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September 8, 2015